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Nos. 84-1584 and 84-1810

In the Supreme Court of the United States

OCTOBER TERM, 1985

WILLIAM F. BONNER, JR., ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

WILLIAM KELLY GLADNEY, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether petitioners were subject to excise tax liability when a private foundation distributed its charitably-dedicated assets to them without notifying the Commissioner of an intent to terminate its private foundation status.

2. Whether the imposition of the excise tax, enacted in 1969, on a 1972 distribution of assets is unconstitutional because the private foundation was created by the terms of a 1905 will.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. B1-B52)[1] is reported at 745 F.2d 955. The opinion of the Tax Court (Pet. App. E1-E51) is unofficially reported at 51 T.C.M. (P-H) ¶ 82,708.

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[1]"Pet. App." refers to the appendix to the Bonner petition, No. 84-1584.

JURISDICTION

The judgment of the court of appeals (Pet. App. C1-C2) was entered on November 5, 1984. A petition for rehearing was denied on February 15, 1985 (Pet. App. D1-D2). The petitions for a writ of certiorari were filed on April 3, 1985 (Bonner) and May 13, 1985 (Gladney). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES INVOLVED

The relevant portions of Sections 507, 4945, and 6104 of the Internal Revenue Code of 1954 (26 U.S.C.) are set forth at Pet. App. A1-A8.

STATEMENT

1. Lelia Bonner Dwyer died testate on June 22, 1905. In her will, Dwyer directed that the real estate she owned be sold and that a portion of the proceeds be used to found and maintain in New Orleans a home for aged and infirm men to be called the John M. Bonner Memorial Home (the Home). Dwyer's husband had been named as the residuary legatee, but he predeceased her; therefore Dwyer's next of kin, her first cousins, became her heirs at law (Pet. App. E7). Petitioners are descendants of those first cousins (Pet. App. B3-B4).

The Home opened in 1915 under the supervision of a charitable corporation known as the Board of Trustees of the John M. Bonner Memorial Home (the Board) (Pet. App. B4). In 1950, the Board requested and received an IRS determination that it was "organized and operated exclusively for charitable purposes" and hence was exempt from taxation under the (1939 Code) (26 U.S.C. (1940 ed.) 101(6)) predecessor of Section 501(c)(3) of the Internal Revenue Code of 1954 (Pet. App. E10-E11).

During the 1950's the number of men at the home began to decrease, and it began having financial difficulties (Pet. App. B4-B5). In 1963, petitioners sued the Board in Louisiana state court, contending that the trust should be dissolved and the remaining assets delivered to them, on the ground that the trust had been completely fulfilled and could no longer be operated as originally contemplated (*id.* at B5). The trial court held in favor of the Board, and the Louisiana Court of Appeal affirmed. *Bonner* v. *Board of Trustees*, 181 So. 2d 255 (1965), writ denied, 248 La. 915, 182 So. 2d 664 (1966). The appellate court found that petitioners had "a right only to submit an alternate plan as to how the general purpose of the Trust can be better accomplished," noting that, since they "are not forced heirs and * * * were completely ignored in the decedent's testament," they "have *no vested rights*." 181 So. 2d at 258 (emphasis added). The court also stated (*ibid.*) that, if petitioners were to prevail in the litigation before it, "the remaining assets of the Trust, * * * would escheat to * * * [petitioners,] which the testatrix never intended."

In 1970, the Board responded to a letter from the IRS by filing a statement to the effect that the Board was a private foundation within the meaning of Section 509(a) of the Code and that it was an operating foundation within the meaning of Section 4942(j)(3) of the Code (Pet. App. B6).[2] In a letter dated July 9, 1971, the IRS notified the Board that it was waiting for promulgation of Treasury Regulations under Section 509 before it could respond to the

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[2]Section 509(a), which was added by the Tax Reform Act of 1969, Pub. L. No. 91-172, § 101(a), 83 Stat. 496, defines a "private foundation" as a charitable organization described in Section 501(c)(3) that, in essence, does not receive broad-based public support. Section 508(b) of the Code establishes a presumption that an organization described in Section 501(c)(3) is a private foundation if it does not notify the Secretary to the contrary.

Board's statement of its foundation status (Pet. App. E16). In a letter dated October 5, 1971, the IRS informed the Board that it had been classified as a private foundation under Section 509(a) and as an operating foundation under Section 4942(j)(3) (Pet. App. B6-B7).

Meanwhile, on July 1, 1971, the Board had closed the Home because the cost of operations was substantially exceeding the revenues of the trust fund. At that time the Home had only two residents (Pet. App. B6). However, the Board still conducted corporate meetings and still had control of the Home's assets (see, *e.g.*, Stip. Exh. 13-M (Minutes of Board Meeting of Sept. 22, 1971)).[3]

On November 5, 1971, petitioners filed in a Louisiana court a petition for a declaratory judgment requesting that the trust be declared dissolved because of the purported nonperformance of the conditions imposed by Mrs. Dwyer and that petitioners be declared entitled to possession of the Home's remaining assets. The Board, in its response, stated that it agreed that it was impractical to continue the trust and that it would leave to the court the decision whether the remaining assets should be delivered to petitioners or transferred to another charity under the doctrine of *cy pres*. On December 23, 1971, the parties submitted the case to the court on a stipulated set of facts, and the court entered its judgment that same day.[4] The court agreed with petitioners

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[3]"Stip. Exh." refers to the stipulated exhibits filed with the Tax Court stipulation of facts.

[4]At a meeting three months earlier between petitioner Edward Lee Gladney and two members of the Board, Mr. Gladney had suggested stipulating to the essential facts of a declaratory judgment action, but one of the Board members had responded (Stip. Exh. 13-M at 4):

> What I am concerned with, lets assume we did get together with everything and went to the court on a joint petition and say "Your Honor, what do we do?" Suppose some third group intervenes

and ordered the assets distributed to them. No appeal was taken Accordingly, on January 18, and March 13, 1972, the Board delivered the remaining assets, valued at $200,596, to petitioners. After delivery of the assets to petitioners, the Board carried on only minimum ministerial functions. Pet. App. B7-B8.

In October 1973, the Board filed with the IRS a form entitled "Form 966-E Liquidation, Dissolution, Termination or Substantial Contraction of Organizations Exempt or Formerly Exempt under Section 501(a)." In this form, the Board stated that it had been dissolved and that a final distribution of assets had been made. The Board made similar statements in subsequent filings with the IRS. Pet. App. B8-B9.

2. On March 21, 1977, the IRS mailed notices to each of the petitioners asserting excise tax liability. The notices stated that the excise tax liability of the petitioners derived from their status as transferees of the assets of the Board, which had incurred that liability by making a noncharitable expenditure in violation of Section 4945 of the Code. The notices asserted liability in the amount of $30,081.28 against each petitioner-transferee, or a total of $210,568.96.[5] In June 1977, petitioners filed petitions in the Tax Court challenging the Commissioner's determinations. Pet. App. B9.

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and said [*sic*] that may be fine that you all agree, but we do not think that that is in accordance with the testator's intent.

No third group intervened, however (see Pet. App. B44 n.3); it is not apparent that either the State or other old age homes had notice of the proceedings.

[5]The parties subsequently agreed that the total transferee liability could not exceed $200,569—the value of the transferred assets at the time of their transfer (Pet. App. B44 n.4).

On December 6, 1982, the Tax Court ruled that the Board, and hence petitioners as transferees, was not liable for the Section 4945 excise tax (Pet. App. E1-E51). Specifically, the Tax Court held that the Board's private foundation status had been terminated upon the entry of the December 1971 judgment of the Louisiana trial court and that, accordingly, the Board's transfer of its assets *after* the entry of that judgment could not give rise to any private foundation tax liability. The Tax Court held that the statutory requirement that the IRS be notified in advance of the termination of private foundation status, Section 507(a)(1) of the Code, was satisfied by the Board's *subsequent* filings, in view of "the state of the law and the factual situation as of the end of 1971" (Pet. App. E31), which included the facts that: (1) the Home had been closed for about six months; (2) the Board's Section 507(c) tax was zero;[6] and (3) the Treasury Department had not yet promulgated regulations giving the specific time and manner for a foundation to file a notice of intent to terminate (Pet. App. E28).

3. The court of appeals reversed (Pet. App. B1-B52). It held that petitioners could not avoid the Section 4945 excise tax by contending that the Board had terminated its private foundation status prior to making the distribution in question because "[t]he statute on its face clearly requires notice before termination of private foundation tax status can take place * * * [and] *[t]he fact is that two years elapsed between the time of the alleged termination (the date of the state court judgment) and the time the Board gave any notice whatsoever*" (Pet. App. B14-B15; emphasis in original). The court also rejected the Tax Court's reliance on the fact that the Board's termination tax liability was zero, pointing out

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[6]Section 507(c) provides for a tax on termination equal to the lesser of the aggregate tax benefit that the organization had derived from being a tax-exempt organization or the current value of its net assets.

that the notice-of-termination requirement of Section 507(a)(1) is not aimed simply at helping the IRS compute the termination tax, but has informational purposes as well, and those purposes would be thwarted if the courts permitted organizations with private foundation status to declare themselves free of such status unilaterally (Pet. App. B15-B21). Judge Politz dissented (*id.* at B30-B42), on the ground that the Board's failure to notify the Commissioner, while erroneous, was "neither heinous not culpable," and therefore the statute should not be read to inflict the "harsh result" brought about in this case (*id.* at B37-B38).

ARGUMENT

The decision of the lower court is correct and does not conflict with any decision of this Court or another court of appeals. Moreover, the case raises no issue even arguably warranting review by this Court because of what petitioners acknowledge to be its "unusual facts" (Bonner Pet. 41).

1. Section 4945 of the Code imposes a 10% initial tax and a 100% "second-tier" tax (if appropriate corrective action is not taken) on the amount of any "taxable expenditure" by a private foundation. This term is defined (Section 4945(d)) as "any amount paid or incurred by a private foundation * * * for any purpose other than one specified in section 170(c)(2)(B)," *i.e.*, any amount paid or incurred for a noncharitable purpose. The court of appeals correctly concluded that the distribution of the assets of a charitable trust for noncharitable purposes falls within the statutory designation.

The court of appeals also correctly concluded that, under the clear and specific terms of Section 507(a) of the Code, the Board could not surrender its "private foundation" status until it notified the Secretary of its intent to terminate

that status.[7] Since the Board gave the Secretary no notice at all of its intention to terminate until October 1973, it is clear that the Board retained private foundation status when it made the noncharitable asset distribution and therefore that the statute imposes liability on the Board, and the petitioners as transferees, for the excise tax that accrued in 1972. Indeed, petitioners do not seriously dispute that the court of appeals was correct in holding that the statute requires imposition of excise tax liability.[8]

2. Petitioners' primary contention (Bonner Pet. 16-45; Gladney Pet. 31-39) is that the imposition of the excise tax unconstitutionally deprived them of property without due

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[7]This notification requirement is not a mere technicality. Apart from the Section 507(c) termination tax, which amounted to zero under the peculiar facts of this case, the notification requirement serves the important purposes of providing information regarding private foundations and enhancing regulation of private foundations by the states (see Pet. App. B16-B21). "[P]rivate foundations are stewards of public trusts" (S. Rep. 91-552, 91st Cong., 1st Sess. 48 (1969)), and the authorities have an interest in seeing that the assets of such foundations are not devoted to noncharitable purposes unnecessarily. In this case, "[i]f State officials had been notified, the State might have intervened in the state court action as parens patriae to protect the charity" (Pet. App. B20); hence, compliance with the statutory notification might have yielded a different result than the noncharitable distribution to petitioners. See note 4, *supra*.

[8]Petitioners do advance (Gladney Pet. 14-30) as a justification for the failure to comply with the statute the fact that regulations under Section 507 were not promulgated until December 1972 (see 37 Fed. Reg. 28157). Relying on *Eger* v. *Commissioner*, 393 F.2d 243 (2d Cir. 1968), they assert that they could not comply with the statute in the absence of implementing regulations. Under *Eger*, however, the proper inquiry in such a situation is whether the facts of the case demonstrate reasonable compliance with the statutory requirements based on the terms of the statute. See *id.* at 247. Here the Board clearly failed to comply at all with the express terms of the statute until October 1973, and thus there is no ground for excusing it from the notification requirement. See Pet. App. B14-B15.

process of law. First, this contention rests on a faulty premise, viz., that petitioners were deprived by the tax of "vested property rights" that they obtained in 1905 at the time of the original devise. In fact, in an earlier proceeding the Louisiana Court of Appeal found that petitioners possessed no such "vested rights," concluding that petitioners' ancestors had been "completely ignored" in the will and the reversion of the Board's assets to petitioners was something the testatrix "never intended." *Bonner* v. *Board of Trustees*, 181 So. 2d 255, 258 (1965), writ denied, 248 La. 915, 182 So. 2d 664 (1966). See *In re Milne's Succession*, 230 La. 729, 751-752, 89 So. 2d 281, 289 (1956) (charitable bequest did not lapse simply because certain conditions could no longer be complied with; rather, *cy pres* must be applied).

In any event, even if petitioners had vested rights in the property prior to the 1972 distribution, the court of appeals correctly held that the tax, enacted in 1969, was not impermissibly retroactive. Obviously, the tax as applied to the Board was not retroactive at all, but rather a prospective tax applied to a distribution three years after its enactment. To the extent the tax is perceived as retroactive as applied to petitioners' alleged reversionary "property interests," the tax is clearly constitutional. As the court of appeals explained (Pet. App. B26-B29), this Court has held in the analogous estate tax area that it is sufficient that a shifting of interests in property occur after enactment of the taxing statute, since "the tax does not operate retroactively merely because some of the facts or conditions upon which its application depends came into being prior to the enactment of the tax." *United States* v. *Jacobs,* 306 U.S. 363, 367 (1939). See also *Fernandez* v. *Wiener,* 326 U.S. 340 (1945).[9]

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[9]Petitioners find crucial significance in the "penal" nature of the tax (Bonner Pet. 27-28; Gladney Pet. 33), but it is well settled that "a tax does not cease to be valid merely because it regulates, discourages, or

Indeed, if petitioners' contention were correct, it would invalidate most applications of the estate tax. Just as petitioners—most of whom were as yet unborn at decedent's death—claim that they obtained vested rights through their grandparents in 1905, so could anyone inheriting an estate challenge the imposition of an estate tax on the theory that his rights in the property vested when his ancestor first obtained the money.

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted.

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even definitely deters the activities taxed." *United States* v. *Sanchez*, 340 U.S. 42, 44 (1950). A tax statute must be upheld as a valid exercise of Congress's taxing power even though revenue-raising is a secondary purpose unless the statute contains "provisions extraneous to any tax need." See *United States* v. *Kahriger*, 345 U.S. 22, 31 (1953), overruled on other grounds, *Marchetti* v. *United States*, 390 U.S. 39 (1968). The statute here, which is part of Congress's scheme to ensure that its original intent in granting organizations tax-exempt status is complied with, plainly is constitutional under this standard. See *Rockefeller* v. *United States*, 572 F. Supp. 9, 12-13 (E.D. Ark. 1982), aff'd, 718 F.2d 290 (8th Cir. 1983), cert. denied, No. 83-1118 (Apr. 30, 1984) (upholding, on this ground, analogous Section 4941 excise tax on private foundation self-dealing).